

15

RECEIVED

MAR 18 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

DOCKET FILE COPY ORIGINAL

**Before the
FEDERAL COMMUNICATIONS COMMISSION**

In the Matter of Revision of Part 22 and Part 90 of the
Commission's Rules to
Facilitate Future Development of Paging Systems and
Implementation of Section 309(j) of the Communications Act --
Competitive Bidding

[WT Docket No. 96-18; PP Docket No. 93-253]

**Comment of the
FEDERAL TRADE COMMISSION**

March 18, 1996*

* By direction of the Commission. Inquiries regarding this Comment should be directed to Bureau of Consumer Protection staff attorneys Heather Hipsley, (202) 326-3285, or Eric J. Bash, (202) 326-2892.

No. of Copies rec'd
List ABCDE

029

I. INTRODUCTION AND SUMMARY

On February 9, 1996, the Federal Communications Commission ("FCC") published a Notice of Proposed Rule Making ("NPRM") soliciting comments on proposed revisions to its paging licensing rules. Generally, the NPRM proposes that the FCC use competitive bidding on a geographic basis to license paging channels. The FCC states that its proposed rules are intended to promote growth and competition in the paging industry by assigning channels to those applicants who will expedite service to the public.¹

The Federal Trade Commission ("Commission" or "FTC") supports the FCC's efforts and believes that the proposed paging licensing procedures will help combat the plague of fraud that has been associated with the licensing of paging and other wireless technologies in the past.² The Commission has extensive experience investigating and litigating cases involving telecommunications investment fraud, including some very recent cases involving paging licenses. By virtue of this experience, the Commission has learned a great deal about the mechanisms through which scam artists have used FCC licensing procedures to perpetrate fraud on consumers. This comment is intended to assist the FCC by addressing several of the proposed rule changes

¹ NPRM, at ¶ 1.

² The Acting Chief of the FCC's Wireless Telecommunications Bureau has stated that stopping "these investment scams will be a top priority for the Wireless Telecommunications Bureau." Michele Farquhar, Remarks at Press Conference (Jan. 30, 1996).

with a view toward reducing the incidence of licensing fraud.³

The Commission, from this standpoint, supports the FCC's proposal for geographic licensing through competitive bidding, and offers ideas for improving the application and auction procedures to deter consumer fraud associated with the FCC's issuance of paging licenses.

II. BACKGROUND: TELEMARKETING FRAUD USING FCC LICENSES

Fraudulent investment schemes that are centered on acquiring FCC licenses for wireless technologies have been the most prevalent telemarketing investment scams of the 1990s, costing consumers hundreds of millions of dollars.⁴ Over a quarter of the total dollar losses reported by consumers to the NAAG/FTC Telemarketing Complaint System database between March and October 1995 involved FCC license-related fraud.⁵

Over the past decade, the Commission has filed twenty-one law enforcement actions against telemarketers engaged in FCC license-related investment fraud. These have involved myriad

³ This comment does not purport to address the merits of the current or proposed rules from a legitimate paging industry standpoint (e.g., appropriate service area size, treatment of incumbents, coverage requirements, etc.), but rather addresses only the implications of the NPRM with respect to allowing or deterring consumer fraud.

⁴ See infra at 3.

⁵ The National Association of Attorneys General ("NAAG")/FTC Telemarketing Complaint System ("TCS") is a nationwide electronic consumer complaint system maintained by the FTC in Washington, D.C. Close to 100 law enforcement agencies use this database.

wireless technologies, such as cellular telephones,⁶ wireless cable,⁷ specialized mobile radio ("SMR"),⁸ and interactive video and data services ("IVDS").⁹ The Securities and Exchange Commission ("SEC") has also filed approximately twenty law enforcement actions against telemarketers engaged in FCC license-related fraud.¹⁰ The combined sales of the companies targeted in the approximately forty actions filed by the FTC and the SEC approach \$400,000,000. Six of the FTC's most recent actions, filed in January 1996 as part of "Project Roadblock," a law enforcement effort of the FTC and twenty-one states targeting hi-tech frauds, involved telemarketers who sold application preparation and acquisition services primarily for paging

⁶ FTC v. American Nat'l Cellular Corp., No. 85-7375-WJR (PX) (C.D. Cal.); FTC v. The Cellular Corp., No. C-85-8231-WHO (N.D. Cal.); FTC v. Continental Communications Corp., No. 88-6876-CIV-ZLOCH (S.D. Fla.).

⁷ FTC v. Applied Telemedia Eng'g & Mgmt. Inc., No. 91-0635-CIV-UNGARO-BENAGES (S.D. Fla.); FTC v. American Microtel, No. CV-S-92-178-LDG(RJJ) (D. Nev.); FTC v. Metro Communications Group, No. 920011-B(CM) (S.D. Cal.); FTC v. Spectrum Resources Group Ltd. & Mass Media I Ltd., No. CV-S-93-00662-HDM (RLH) (D. Nev.).

⁸ FTC v. Digital Communications Inc., No. 93-6648-JGD (C.D. Cal.); FTC v. Metropolitan Communications Corp., No. 94-Civ-0142 (JFK) (S.D.N.Y.); FTC v. Network Communications Ltd., No. 96-CIV-0567 (SHS) (S.D.N.Y.).

⁹ FTC v. Chase McNulty Group Inc., No. 95-524-CIV-T-25E (M.D. Fla.); FTC v. Digital Interactive Assocs. Inc., No. 95-Z-754 (D. Colo.).

¹⁰ See SEC, Litigation Release entitled "Telecommunications Technology Securities Fraud" (Jan. 25, 1996). State regulators have also been active in bringing law enforcement actions to deter these frauds.

licenses.¹¹ The FCC assisted this effort by providing the FTC with consumer complaints and expertise on paging licensing and other FCC procedures.

Telecommunications investment frauds associated with FCC licenses are of two basic types: "license application mills" and "build-out" schemes. License application mills sell application preparation services for acquisition of FCC wireless licenses, and typically charge a fee of several thousand dollars per license. Promoters of build-out schemes usually sell interests in limited liability companies or general partnerships which supposedly will acquire FCC wireless licenses and build and operate telecommunications systems that use these licenses. These promoters also charge a fee of several thousand dollars per interest.

Both schemes are carried out through telemarketing sales calls placed to inexperienced, unsophisticated consumers located

¹¹ FTC v. Alliance Communication Inc., No. 96-CIV-0568 (DC) (S.D.N.Y.) (hereafter, "Alliance"); FTC v. Bell Connections Inc., No. 96-0455 KMW (SHx) (C.D. Cal.) (hereafter, "Bell"); FTC v. Micom Corp., No. 96-CIV-0472 (SS) (S.D.N.Y.) (hereafter, "Micom"); FTC v. North East Telecommunications Ltd., No. 96-6081-CIV-Gonzalez (S.D. Fla.) (hereafter, "North East"); FTC v. On Line Communications Inc., No. CV-S-96-00055-LDG (RLH) (hereafter, "On Line"); FTC v. USA Channel Systems Inc., No. 96-0454 HLH (CTx) (C.D. Cal.) (hereafter, "USA").

In addition to cellular telephone, wireless cable, SMR, IVDS, and paging cases, the FTC has also filed cases against "brokers" that purport to secure leases or sales of FCC licenses for consumer licensees, FTC v. Falcon Crest Communications Inc., No. CV 95-4881 (ADS) (E.D.N.Y.), and has filed cases against "recovery rooms" that purport to recover monies lost by consumers to application mills or build-out schemes. FTC v. Meridian Capital Mgmt., No. CV-S-96-63-PMP-(RLH) (D. Nev.); FTC v. United Consumer Servs. Inc., No. 1:94-CV-3164-CAM (N.D. Ga.).

throughout the United States. Scam artists often identify consumer targets by purchasing FCC databases of wireless licensees, which include consumers who acquired licenses through earlier scams.¹²

The typical application mill sales "pitch" is that FCC wireless licenses are investment products worth many times the telemarketer's fee of thousands of dollars, because customers will be able to lease or sell their licenses to telecommunications systems operators without themselves having to build and operate a system that would use the license. The typical build-out scheme "pitch" is that an investment interest in the telecommunications business operated by the limited liability or general partnership will be worth many times the telemarketer's fee, due to the sure success of the business. Although details of the schemes and technology may vary, the end result is the same: consumers are deceived about the profitability and risk of FCC license acquisitions and lose most, if not all, of their investments.

¹² For example, in Bell, one of the individual defendants testified during his deposition that the corporate defendant acquired its customer "lead" list by purchasing the names of applicants or licensees for other FCC licenses from one of the FCC's contractors. See Deposition of Donald Dayer (Jan. 31, 1996). In addition, in Micom, a salesperson has stated in a sworn declaration that "every lead furnished to me was taken from the FCC data base...." See Declaration of David Bozic (filed Mar. 1, 1996). See also infra at 6-7 (discussion of FCC databases).

III. AWARDING PAGING LICENSES THROUGH COMPETITIVE BIDDING LIKELY WILL REDUCE FRAUD ASSOCIATED WITH APPLICATION MILLS

Our past experience shows that fraudulent application mill schemes thrive where licenses are readily available, in part because they are not in demand by legitimate telecommunications companies. In such situations, telemarketers, as part of their pitch, can virtually guarantee that consumers will receive licenses. The consumer, having obtained a license as promised, is not likely to complain for quite some time, given the telemarketer's assurance that the license is a valuable passive investment. Thus, telemarketers can profit handsomely while avoiding early and easy detection.

In the Commission's "Project Roadblock" cases, the telemarketer defendants operated application mills for paging licenses. These licenses included mostly non-exclusive 929 MHz and exclusive 931 MHz channels, as well as some exclusive 454 MHz channels.¹³ The telemarketers sold their services for roughly \$1,500 to \$12,000 per application, and, in five of these cases alone, took in well over \$13,000,000.

The FCC's paging license databases suggest the magnitude of telemarketers' abuses as well. As of February 1996, the FCC's database of licensees for the five 929 MHz non-exclusive frequencies identifies over 3,600 individual consumers -- instead

¹³ See Complaints filed in Alliance (selling services for mostly 929 MHz licenses); Bell (mostly 454, 929 & 931 MHz licenses); Micom (800, 929 & 931 MHz licenses); North East (mostly 929 MHz licenses); On Line (929 MHz licenses); USA (931 MHz licenses).

of paging or other businesses -- as licensees.¹⁴ As of March 5, 1996, the FCC's database of pending applications for 931 MHz licenses lists over 2,700 individual consumers as applicants.¹⁵ Many of these pending applications and licenses listed under individual consumer names were likely applied for and/or obtained through application mills.¹⁶ In short, the application mills have caused the FCC to process and grant license applications for thousands of consumers who almost certainly have neither the intention nor the financial wherewithal to provide telecommunications service,¹⁷ rather than for bona fide businesses that need and use paging channels.

The database of pending applications for 931 MHz licenses alone suggests the pernicious effect these frauds have had on the integrity of the FCC's current licensing processes. The database

¹⁴ In arriving at this figure, licensees listed under a personal name, rather than a business name, such as a corporation, partnership, or hospital, were considered to be "individual consumers."

¹⁵ "Pending applicants" includes applications for new channels only and excludes modification applications by incumbents to expand on existing channels.

¹⁶ The Commission is aware that some "individual consumer" licensees may have acquired licenses for legitimate purposes, and are not the victims of scams. However, a recent search of the FCC databases revealed the names of literally hundreds of consumers who invested with the "Project Roadblock" defendants, often purchasing two or more licenses. This is not surprising given that these defendants have used the databases as "lead sheets." See supra note 12. These facts lead the Commission to conclude that many, if not most, of the "individual consumers" listed are indeed scam victims.

¹⁷ See, e.g., Micom, Exhibits in Support of TRO (Jan. 24, 1996).

identifies fully 72% of the total number of pending applicants as individual consumers.¹⁸ These consumers, mere grist for the application mills, may, in large part, account for the FCC's application backlogs in the 931 MHz bands, occasioned by competing applications for the same service areas.¹⁹

The FCC's geographic licensing and competitive bidding proposal likely will inhibit paging application mill fraud. The proposed change to geographic licensing makes considerably fewer paging licenses available, reducing the ready supply of licenses on which the fraudulent telemarketers thrive. An application mill is unlikely to be able to "guarantee" licenses to its customers, eliminating a major selling point of the investment opportunity. Moreover, competitive pressures under the new rules make obtaining these licenses more costly for fraudulent telemarketers. For example, the FCC's proposal to require bidders to post upfront payments (§§ 104-105) and the winning bidders to post a 20% down payment (§ 106), will impose costs that fraudulent telemarketers may not wish to assume. In addition, competitive bidding will help prevent telemarketers from deriving huge profits based on the mark-up between the FCC's modest application fees and the telemarketers' required consumer "investment fees."

¹⁸ There are 3,856 pending applications for 931 MHz licenses; 2,784 of these are individual consumers.

¹⁹ See, e.g., in Bell, Micom, North East, On Line, and USA, Declaration of David Furth, Attachment 1 (declaration signed Jan. 19, 1996) (including Petition of MetroCall Inc. to deny application of application mill customer for paging channel).

The likely deterrent effect of competitive bidding on application mill fraud (along with an interim freeze on new applications) is evidenced by the Commission's past experience with FCC licensing fraud.²⁰ As the application mills have moved from one wireless technology to the next, they have generally moved away from technologies licensed by competitive bidding, and toward those licensed on a first-come, first-served basis.²¹

Non-Exclusive Licenses

The FCC expressly seeks comment on whether to convert "shared" paging channels to exclusive use, to issue a limited number of licenses per shared channel, or to retain the "status quo."²² The Commission offers no comment on these alternatives from the standpoint of general telecommunications policy.

²⁰ Clearly, the interim freeze against accepting new applications also has a strong deterrent effect on application mill fraud. For example, during the FCC freeze against accepting new SMR applications, a Micom salesperson told an undercover FTC investigator that she could not invest in SMR licenses because of the freeze, and encouraged her to invest in paging licenses. After the FCC lifted the freeze, Micom sold SMR services again.

²¹ Indeed, some of the "Project Roadblock" defendants who offered paging licenses were previously connected with SMR application mills. See, e.g., in Micom, Exhibits in Support of TRO (Jan. 24, 1996); in USA, Memorandum of Points & Authorities in Support of TRO (Jan. 24, 1996).

²² See NPRM, at ¶¶ 31, 32. The NPRM expressly excludes 929 MHz shared channels from the analysis for 152/158, 462 and 465 MHz channels. The NPRM does not expressly include the 929 MHz shared channels in its proposal to implement geographic licensing for 931 and 929 MHz paging channels. (¶¶ 24, 25) The text of this comment treats 929 MHz shared channels as if they were included in the NPRM discussion of lower band private carrier paging shared channels.

However, based on its extensive law enforcement in the area of telecommunications investment fraud, the Commission believes that either the alternative to eliminate shared licenses altogether, or to limit the number of licenses per shared channel, would have a major impact on reducing certain frauds. In reviewing the FCC's database of 929 MHz shared licenseholders, 92% are individual consumers, many of whom would appear to be customers of application mills.²³ Fraudulent telemarketers easily abuse the current process that licenses shared channels without limitation.

In the Commission's recent "Project Roadblock" cases, five of the seven telemarketers hawked 929 MHz shared licenses for several thousand dollars per license. Telemarketers guaranteed paging licenses for such major markets as New York, and were able to deliver on their promises in the form of a 929 MHz shared channel. Because telemarketers delivered, they were able to "reload" many unwitting customers for more money to purchase additional major market "shared" licenses. In short, the "shared" licensing process provided an opportunity for scam artists to make money with little risk of immediate detection. Consumers, on the other hand, are left with little more than a piece of paper as they come to the realization that their shared licenses cannot be leased or sold as promised, and are virtually

²³ There are 4,003 licenseholders listed in the database for all five 929 MHz shared channels; 3,687 are individual consumers. The Commission is aware that some individual consumers may not have purchased through application mills. See supra note 16.

worthless for investment purposes.²⁴ Given the application mills' misuse of the current licensing process for "shared" channels, the Commission strongly endorses changing the status quo to at least limit "shared" channel licensing.

IV. THE COMPETITIVE BIDDING RULES CAN BE IMPROVED TO DETECT AND DETER UNQUALIFIED APPLICANTS WHO MAY BE VICTIMS OF FRAUD

While the FCC's proposed competitive bidding process likely will deter application mill fraud, it may not eliminate other types of fraud centered on FCC licenses, such as build-out schemes. The Commission has filed law enforcement actions against two telemarketers for alleged deception in connection with IVDS licenses, which were recently awarded through competitive bidding.²⁵ In both of these cases, telemarketers sold consumers interests in partnerships that supposedly would operate a telecommunications systems using IVDS licenses acquired through auction. In one of the cases, the partnership itself was the bidder, but the telemarketer pocketed the majority of the money it raised, and rendered the partnership financially incapable of building and operating a telecommunications system that would generate the kind of financial returns promised.²⁶

²⁴ These consumers are also victimized by license "brokers" who claim to procure for consumer-licensees leases or purchases for their licenses from system operators. See, e.g., FTC v. Falcon Crest Communications Inc., CV 95-4881 (ADS) (E.D.N.Y.).

²⁵ See Chase McNulty Group, supra note 9; Digital Interactive Assocs., supra note 9.

²⁶ Chase McNulty Group, supra note 9.

In the other case, through a series of transactions, the auction winner (an affiliate of the telemarketer) ultimately will transfer the IVDS license to a partnership of consumer investors, but for over fifteen times the amount of the winning bid.²⁷

The Commission supports the FCC's goal to structure competitive bidding rules "to ensure that bidders and licensees are qualified and will be able to construct systems quickly and offer service to the public." (§ 95) While the Commission offers no view on the proposed rules from the standpoint of telecommunications policy, the Commission believes that certain proposed bidding procedures will help deter fraud. These measures include the proposed rules that require a bidder to disclose its business classification (§ 100), to post upfront payments (§§ 104-05), and to post a down payment in short order (§ 106). The Commission believes that the proposed transfer disclosure rules that would carefully scrutinize a transfer of a license by an auction winner who had not yet begun commercial service (§ 112) also would help deter fraud.²⁸ These disclosures to the FCC would inhibit fraudulent telemarketers

²⁷ Digital Interactive Assocs. Inc., supra note 9.

²⁸ Restrictions on the purchase and subsequent resale of licenses, while deterring licensing fraud, can be costly if they impede the efficient reallocation of scarce resources to their highest-valued use. Transfer disclosure rules are preferable to transfer prohibitions, particularly in an industry in which the best use of assets may change as technologies develop. See, e.g., Comment of the Staff of the Bureau of Economics and the San Francisco Regional Office of the Federal Trade Commission In The Matter of Competition, Rate Deregulation and the MM Docket No. 89-600 Commission's Policies Relating to the Provision of Cable Television Service, April 20, 1990.

from obtaining a license at auction, and then "flipping" it to coalitions of unqualified and unsuspecting consumers for a multiple of its auction value.

The Commission believes, however, that the proposed bidding procedures can be strengthened further "to ensure that auction winners have the necessary financial capabilities to complete payment for the license and to pay for the costs of constructing a system" (§ 106), and thereby prevent fraudulent abuse of the auction process. For example, the NPRM seeks comment on whether the FCC should require further ownership disclosures. (§ 100) The Commission suggests that applicants should be required to disclose to the FCC, prior to auction, the identities of the real parties in interest (e.g., partners or shareholders) and financial information about the proposed licensees (e.g., the limited liability company or general partnership). In addition, the Commission suggests that applicants should certify, prior to auction, that the licensee will comply with any FCC transfer restrictions and performance requirements. (§§ 111-113) Such pre-auction application requirements would assist the FCC in rooting out unqualified applicants and the Commission in exposing fraudulent actors.

The Commission further suggests that the application and competitive bidding procedures require that bidding agents and application preparers disclose material information about paging license regulations to the licensee and real parties in interest, e.g., partners or shareholders. Such requirements would enhance

the FCC's efforts to ensure that only qualified applicants obtain paging licenses. A fundamental problem in FCC license related fraud cases has been that potential consumer licensees do not have complete relevant information about the FCC licenses when they make an investment decision. Consumers have stated that if they had known more about the FCC regulations governing paging licenses, they would have realized that the licenses were not a proper "investment" vehicle and would not have been taken in by fraudulent marketing schemes.²⁹ The Commission therefore suggests the inclusion of a requirement that application preparers or bidding agents disclose material information, such as auction rules including payment schedules, transfer restrictions, and performance requirements, to their customers or clients -- the potential licensee.

V. CONCLUSION

The Commission would welcome the opportunity to have its staff meet with appropriate FCC personnel to discuss the issues raised in this comment.³⁰

²⁹ See, e.g., Letter to FTC from Patricia Rand (Feb. 24, 1996) ("I do wish the FCC had issued a warning when these licenses were released ... that these licenses were no good to the little guy and not to be taken in by marketing schemes.... [The FCC "consumer alert" circulated after she made her investment] was issued much too late."); Letter to FTC from Kenneth F. Trofatter (Feb. 13, 1996).

³⁰ The Commission would like to assist the Wireless Telecommunications Bureau in protecting "the integrity of the Commission's [FCC's] processes," and ensuring that "auctions provide a fast, fair, and efficient way to [award] licenses ... to those who value them most." Michele Farquhar, Remarks at Press Conference (Jan. 30, 1996).